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UNITED DRUG, INC.

ANNUAL REPORT

December 31, 1944

CORP. FILE

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Transfer Agents

For UNITED DRUG, INC.

Guaranty Trust Company of New York, New York

State Street Trust Company, Boston

For UNITED DRUG COMPANY

The Commercial National Bank and Trust Company of New York, New York

Registrars

The Chase National Bank of the City of New York, New York

The National Shawmut Bank of Boston, Boston

J. P. Morgan & Co. Incorporated, New York

Counsel

Gaston, Snow, Rice and Boyd, Boston

Root, Clark, Buckner and Ballantine, New York

March 10, 1945

To the Stockholders of United Drug, Inc. and United Drug Company:

SALES

Consolidated sales of your company and its subsidiaries for 1944 totaled $147,793,341, including December sales of the new Sontag division, compared with a previous high of $138,913,407 in 1943. The increase of $8,879,934 was at the rate of 6.4%. Sales in 1942 were $121,997,977 and in 1941, $102,460,960.

EARNINGS

For the year ended December 31, 1944, the consolidated net income of United Drug, Inc. and its subsidiaries amounted to $2,666,530 after providing for depreciation, bond interest, loss from Real Estate operations, Federal and Canadian income and excess profits taxes, reserves and other charges; and after deducting dividends of $475,000 on the Preferred Stock of United Drug Company, earnings amounted to $2,191,530, or $1.56 per share, applicable to the capital stock of United Drug, Inc. This compares with $2,385,025, or $1.70 per share for 1943.

COMPARATIVE SUMMARY OF CONSOLIDATED INCOME

	1944	1943
1. We earned a consolidated net operating profit of	$13,698,839	$13,881,103
2. To which we added investment and interest income, etc.	85,564	127,250
	$13,784,403	$14,008,353
3. From which we deducted:		
(*a*) Additions to General Reserve	...	335,000
(*b*) Provision for possible losses incident to postwar reconstruction of retail store chains, etc.	500,000	500,000

	1944	1943
(c) Interest on Funded Debt . . .	635,038	1,350,332
(d) Loss from real estate operations .	102,856	124,824
(e) Cancellation of real estate lease. .	. . .	1,386,000
(f) Provision for Federal and Canadian income and excess profits taxes, and for renegotiation . . .	9,055,000	7,450,000
(g) Plant moving and rearrangement expenses and other extraordinary charges, etc.	824,979	251,547
4. Total Non-Operating Deductions . . .	$11,117,873	$11,397,703
5. Leaving a Net Profit applicable to capital stock of United Drug Company . .	$2,666,530	$2,610,650
6. Preferred Stock Dividends paid or declared by United Drug Company (subsidiary) .	475,000	225,625
7. Profit applicable to capital stock of United Drug, Inc.	$2,191,530	$2,385,025
8. EARNINGS PER SHARE	$1.56	$1.70

CASH AND WORKING CAPITAL

Current assets as of December 31, 1944 totaled $56,283,233 including cash, marketable securities and United States Government Notes in the amount of $21,866,528.

Current liabilities, including a reserve of $10,921,356 for United States and Canadian Income and Excess Profits taxes, were $22,612,525, leaving net working capital of $33,670,708, an increase of $978,053 during the year.

SURPLUS

Earned surplus as shown on the consolidated balance sheet of December 31, 1944, amounted to $11,317,678, compared with $12,096,456 a year earlier. Among the charges to surplus during 1944 was $2,999,999 for write-off of goodwill, reducing that item to $1 as against an amount of $3,000,000 at the end of 1943, and $10,401,169 in 1933.

INVENTORIES

At the year-end, inventories were valued at $28,308,686 including $1,950,451 in the newly acquired Sontag division, the total comparing with $29,152,868 at the end of 1943.

DIVIDEND POLICY

No dividends were paid on the capital stock of United Drug, Inc. in 1944. No change in dividend policy is contemplated by your Directors in 1945.

Before the war started your company was faced with the necessity of spending substantial sums to improve its store equipment and facilities and to consolidate and modernize its manufacturing plants. The war has both delayed the making of these expenditures and increased the need for them.

We feel that the earnings of your company should be retained to provide an adequate surplus for the execution of this program.

A strong financial position will also help safeguard the company against the many uncertainties that business and industry may have to face during world readjustment.

The net asset value of the Capital stock of United Drug, Inc. exclusive of goodwill, has increased $1.58 during the year to $13.36 as of December 31, 1944 compared with $11.78 as of the same date the previous year.

TAXES

Provisions for Federal and Canadian income and excess profits taxes (including renegotiation for 1944) for the past three years have been

1942	$5,150,000
1943	7,450,000
1944	9,055,000

RESERVES

An additional $500,000 was added to the reserve set-up for your company's postwar rehabilitation and training program. A similar amount was provided in each of the two previous years. No additions were made to contingency and general reserves as they were considered to be adequate.

SONTAG DIVISION

As of November 30, 1944 United Drug Company acquired by purchase the assets of Sontag Chain Stores Co., Ltd., which operated 48 drug stores in California, mostly in the southern part of the State. This company was organized in 1929. Average volume per store is substantial, rentals are satisfactory and earnings have been consistent. Your directors believe that this is a desirable addition to the facilities of your company. The chain will be operated as the Sontag Division of United Drug Company.

UNITED DRUG COMPANY

Separate consolidated financial statements of United Drug Company and its subsidiaries have not been submitted because of their close similarity to the consolidated statements of United Drug, Inc. If anyone desires a copy of these statements, it will be sent on request.

POSTWAR PLANS

National advertising for Rexall products is considered to be an essential part of our merchandising plans. It has already started in magazines, and we will go on the air as soon as suitable network time is available.

Formulation of our program for re-education of returning service personnel is nearing completion.

Further plans for rearrangements and improvements of physical properties have been developed and are ready to be put in effect as soon as restrictions are lifted. Rexall drug stores everywhere will share in the benefits of Rexall planning.

The progress of your company during the past year would have been impossible without the efficiency and loyalty of the employees. Working under many difficulties they have contributed immeasurably, not alone to the war effort but to the maintenance of public health on the home front. We deeply appreciate their whole-hearted co-operation.

Respectfully submitted,

J. W. DART, *President*
UNITED DRUG, INC.

PRICE, WATERHOUSE & CO.

75 FEDERAL STREET

BOSTON 10

March 5, 1945

To the Board of Directors
of United Drug, Inc.:

We have examined the consolidated balance sheet of United Drug, Inc. and its subsidiary companies as of December 31, 1944 and the related consolidated statements of profit and loss, earned surplus and capital surplus for the year ending on that date. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances, and included such tests of the accounting records and other supporting evidence and such other procedures as we considered necessary, including the verification of the cash in banks through certificates obtained from the depositaries, inspection or confirmation of the securities, observations and test counts of the inventories and test confirmations of the receivables by correspondence with debtors other than certain U. S. Government departments. It was found to be impracticable to obtain confirmation of receivables from all U. S. Government departments, but we satisfied ourselves by other means as to these balances.

In our opinion, the accompanying consolidated balance sheet and related consolidated statements of profit and loss, earned surplus and capital surplus, with the accompanying notes to financial statements, present fairly the consolidated position of United Drug, Inc. and its subsidiary companies at December 31, 1944, and the consolidated results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent, in all material respects, with that of the preceding year.

PRICE, WATERHOUSE & CO.

UNITED DRUG, INC. AND

CONSOLIDATED BALANCE S

(WITH COMPARATIVE FIGUR

ASSETS

	December 31, 1944	1943
CURRENT ASSETS:		
Cash in banks and on hand	$14,158,045	$11,203,381
United States Treasury Notes, tax series (*cost and face amount*)	7,100,000	4,000,000
Canadian Government bonds, Canadian call loans and other foreign securities (*value based on market quotations, approximately $705,000 in 1944 and $689,000 in 1943*)	608,483	633,833
Customers' accounts and notes receivable, less reserves (*Note 3*)	4,732,206	4,979,650
Other accounts and notes receivable	1,375,813	695,348
Inventories of merchandise, partly finished stocks, materials and supplies — at cost or market whichever lower (*Note 4*)	28,308,686	29,152,868
TOTAL CURRENT ASSETS	$56,283,233	$50,665,080
INVESTMENTS AND ADVANCES, ETC.:		
Investments in and advances to wholly-owned English and South African subsidiaries, not consolidated (*Note 2*)	$ 348,676	$ 331,211
Miscellaneous investments, at or below cost, less reserve (*Note 5*)	851,703	201,899
Non-current accounts and notes receivable, advances and deposits, less reserves (*Note 3*)	222,756	259,483
Postwar credits of federal and Canadian excess profits taxes (*estimated*)	674,938	36,938
	$ 2,098,073	$ 829,531
PROPERTY ACCOUNTS — at cost, written down amounts, or appraisal valuations (*including store fixtures and improvements of retail companies at appraisal valuations determined in 1933, as approved by the directors, plus subsequent additions at cost*):		
Land, buildings and building fixtures	$ 9,055,721	$ 8,956,099
Machinery and equipment, etc.	8,564,815	8,682,298
Store fixtures and improvements, etc.	12,682,717	12,189,523
	$30,303,253	$29,827,920
Less — Reserves for depreciation	16,976,442	16,078,403
	$13,326,811	$13,749,517
DEFERRED CHARGES:		
Prepaid insurance, taxes, rent, etc. and advertising supplies	$ 899,476	$ 687,208
Unamortized expense on debentures of United Drug Company	127,140	131,639
	$ 1,026,616	$ 818,847
GOODWILL, TRADE-MARKS, ETC. (*Note 6*)	$ 1	$ 3,000,000
	$72,734,734	$69,062,975

(Reference is made to the accom

) SUBSIDIARY COMPANIES

SHEET — DECEMBER 31, 1944

ES AS AT DECEMBER 31, 1943)

LIABILITIES

	December 31, 1944	1943
CURRENT LIABILITIES:		
Accounts payable (*trade, etc.*) and accrued expenses	$10,996,882	$10,052,601
Real estate purchase obligations maturing within one year	8,090	7,696
Accrued interest on debentures	256,872	263,697
Sinking fund payment due within one year on debentures of United Drug Company (*portion not provided for by treasury debentures on hand*)	310,575	143,500
Preferred stock dividend declared	118,750	118,750
Reserves for estimated federal and Canadian income and excess profits taxes and, in 1944, for renegotiation (*Note 7*)	10,921,356	7,386,181
TOTAL CURRENT LIABILITIES	$22,612,525	$17,972,425
FUNDED DEBT OF UNITED DRUG COMPANY:		
Fifteen Year 3¼% Sinking Fund Debentures, due August 1, 1958:		
Authorized and issued, less retired	$19,333,000	$20,000,000
Less — Debentures to be retired through sinking fund within one year — provided for above and by debentures held in treasury ($364,000 *in 1944 and* $527,000 *in 1943*)	667,000	667,000
	$18,666,000	$19,333,000
Real estate purchase obligations maturing after one year	194,435	202,525
	$18,860,435	$19,535,525
RESERVES:		
For possible losses incident to contemplated postwar reconstruction of retail store chains and for postwar personnel training expenses	$ 1,500,000	$ 1,000,000
General reserves for other possible future losses and adjustments attributable to war conditions and for other contingencies	1,300,000	1,300,000
Miscellaneous reserves (*for maintenance, etc.*) and deferred income	272,118	292,954
	$ 3,072,118	$ 2,592,954
PREFERRED STOCK OF UNITED DRUG COMPANY, $4.75 CUMULATIVE (*Note 8*):		
Authorized and issued — 100,000 shares without par value, at stated value of $100 per share	$10,000,000	$10,000,000
CAPITAL STOCK OF UNITED DRUG, INC. AND CONSOLIDATED SURPLUS:		
Capital stock:		
Authorized and issued — 1,400,560 shares, par value $5 each	$ 7,002,800	$ 7,002,800
Capital surplus — per accompanying statement	393,275	392,305
Earned surplus since September 1, 1933 (*Note 9*) — per accompanying statement	11,317,678	12,096,456
	$18,713,753	$19,491,561
Less — Capital stock of United Drug, Inc. acquired and held by United Drug Company (*Note 10*) — 48,478 shares in 1944 and 48,977 shares in 1943, at cost	524,097	529,490
	$18,189,656	$18,962,071
	$72,734,734	$69,062,975

panying notes to financial statements)

UNITED DRUG, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDING DECEMBER 31, 1944

(WITH COMPARATIVE FIGURES FOR 1943)

	Year ending December 31, 1944	1943
Sales, less returns, allowances and discounts	$147,793,341	$138,913,407
Cost of sales, selling, general and administrative expenses (*including depreciation of $1,337,220 in 1944 and $1,359,316 in 1943*)	134,094,502	125,032,304
Profit from operations	$ 13,698,839	$ 13,881,103
Dividends, interest and other income (*partly net*)	85,564	127,250
	$ 13,784,403	$ 14,008,353
Other charges:		
Interest and amortization of expense on debentures	$ 635,038	$ 1,350,332
Other interest expense	12,844	11,457
Loss from real estate operations	102,856	124,824
Payment in consideration of the cancellation of a real estate lease	...	1,386,000
Cost of leaseholds, etc. purchased during the year	157,587	86,428
Plant moving and rearrangement expenses and other extraordinary charges	654,548	153,662
Provision for estimated federal and Canadian taxes on income and, in 1944, for renegotiation (*Note 7*):		
Federal normal income tax and surtax	1,376,000	883,000
Federal excess profits tax and renegotiation (*before reduction for tax savings of $14,000 in 1944 and $735,000 in 1943 reflected in earned surplus*)	7,466,000	6,315,000
Canadian income and excess profits taxes	213,000	252,000
Provision for possible losses incident to contemplated postwar reconstruction of retail store chains and for postwar personnel training expenses	500,000	500,000
Additions to general reserves for other possible future losses and adjustments attributable to war conditions and for other contingencies	...	335,000
	$ 11,117,873	$ 11,397,703
Net profit before dividends on preferred stock of United Drug Company (*for 1944, represents the consolidated net profit for the year of United Drug Company and its subsidiary companies—Note 1*)	$ 2,666,530	$ 2,610,650
Dividends on preferred stock of United Drug Company — $4.75 per share in 1944 and $2.37½ per share (*less adjustment on sale of stock*) in 1943	475,000	225,625
Net profit for the year applicable to capital stock of United Drug, Inc., carried to earned surplus	$ 2,191,530	$ 2,385,025

(Reference is made to the accompanying notes to financial statements)

UNITED DRUG, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF SURPLUS EARNED SINCE SEPTEMBER 1, 1933 FOR THE YEAR ENDING DECEMBER 31, 1944

(WITH COMPARATIVE FIGURES FOR 1943)

	Year ending December 31, 1944	1943
Balance at beginning of year	$12,096,456	$13,303,619
Add:		
Net profit for the year applicable to capital stock of United Drug, Inc. — per accompanying statement	2,191,530	2,385,025
Prior years' estimated Canadian postwar credits of excess profits taxes, reflected in surplus in 1944, and adjustment of unrealized Canadian exchange losses	36,160	11,745
	$14,324,146	$15,700,389
Deduct:		
Reduction in carrying value of goodwill, trademarks, etc. (*Note* 6)	$ 2,999,999	$ 3,300,000
Premiums paid on redemption or purchase of United Drug Company debentures, less federal excess profits tax savings of $14,000 in 1944 and $735,000 in 1943 attributable thereto:		
5% debentures ($30,499,000 *principal amount*)	...	174,182
3¼% debentures ($504,000 *principal amount in 1944 and* $527,000 *in 1943*)	6,469	533
Portion not charged to capital surplus, of underwriting discount or commission and expenses on issuance of preferred stock of United Drug Company	...	129,218
	$ 3,006,468	$ 3,603,933
Balance at close of year, carried to balance sheet (*Note* 9)	$11,317,678	$12,096,456

CONSOLIDATED STATEMENT OF CAPITAL SURPLUS FOR THE YEAR ENDING DECEMBER 31, 1944

(WITH COMPARATIVE FIGURES FOR 1943)

	Year ending December 31, 1944	1943
Balance at beginning of year	$ 392,305	$ 588,319
Add (*Deduct*):		
Excess, over average cost, of the proceeds from the sale, under a stock option agreement (*Note* 10), of 500 shares of United Drug, Inc. capital stock held by United Drug Company	970	...
Portion of underwriting discount or commission and expenses on issuance of preferred stock of United Drug Company, charged to capital surplus to the extent of capital surplus considered available therefor	...	(196,014)
Balance at close of year, carried to balance sheet	$ 393,275	$ 392,305

(Reference is made to the accompanying notes to financial statements)

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — BASIS OF CONSOLIDATION, ETC.

The accompanying consolidated financial statements of United Drug, Inc. and subsidiary companies include the accounts of United Drug, Inc. (*parent holding company*), United Drug Company (*parent operating company, all of the common stock of which is owned by United Drug, Inc.*) and the domestic and Canadian subsidiaries (*all of which are wholly owned by United Drug Company*). The English and South African subsidiaries of United Drug Company have not been consolidated.

Separate consolidated financial statements of United Drug Company and its subsidiaries have not been submitted because of their close similarity to the consolidated statements of United Drug, Inc. A consolidated balance sheet of United Drug Company would not include the assets and liabilities of United Drug, Inc., which are summarized in the following paragraph. The consolidated results of United Drug Company and its subsidiaries, as well as of United Drug, Inc. and its subsidiaries, are reflected in the accompanying consolidated statement of profit and loss for the year ending December 31, 1944, as indicated therein and as further explained in the following paragraph.

As of December 31, 1944 the assets of United Drug, Inc. consisted of cash, $20,491, receivables from certain subsidiaries, $62,746, and its investment in the common stock of United Drug Company, carried on its books at $8,139,099. Its liabilities consisted of $51,600 payable to United Drug Company and miscellaneous accrued expenses of $9,518. The intercompany investment amount and intercompany receivable and payable balances are eliminated in the consolidated accounts of United Drug, Inc. The operations of United Drug, Inc., as a separate corporation, resulted in no net gain or loss in 1944 (*as compared with a net loss of $5,990 in 1943*), inasmuch as, for 1944, the administrative service charges to subsidiaries, representing the only income of United Drug, Inc., were equal in amount to the general and administrative expenses incurred by United Drug, Inc.

The 1944 consolidated figures include the December 31, 1944 assets and liabilities relating to the Sontag business, acquired as of November 30, 1944 (*Note 5*), and the operating results of this business for the month of December 1944.

NOTE 2 — FOREIGN ASSETS AND EARNINGS

The accompanying consolidated balance sheet at December 31, 1944 includes assets and liabilities of the Canadian subsidiaries in the following amounts, expressed in U. S. dollars: current assets, $2,665,827, current liabilities, $429,290, fixed properties and other assets, $778,519. The consolidated net profit amounts set forth in the accompanying statement of profit and loss include $169,990 for 1944 and $128,014 for 1943 of undistributed Canadian earnings, expressed in U. S. dollars.

The investments in and advances to wholly-owned English and South African subsidiaries, not consolidated, carried at $348,676 at December 31, 1944, were represented as of that date by underlying net assets (*mostly current*) of these companies amounting to approximately $542,000, as shown on their books and converted into U. S. dollars. This amount is based, in part, on tentative figures which are not expected to vary materially from those which will be finally reported. Earnings of the English and South African subsidiaries, amounting to approximately $30,000 in 1944 and $29,000 in 1943, in U. S. dollars, have not been reflected in the accompanying consolidated statement of profit and loss except to the extent of $1,206, both in 1944 and 1943, of dividends realized in U. S. dollars from the English subsidiary.

NOTE 3 — ACCOUNTS AND NOTES RECEIVABLE, ETC.

Customers' accounts and notes receivable (*current*) include $369,097 in 1944 and $513,949 in 1943 owing from United States Government departments, and are stated net after deducting reserves of $595,245 in 1944 and $575,594 in 1943.

Non-current accounts and notes receivable, advances and deposits include $63,151 in 1944 and $59,383 in 1943 owing from employees.

NOTE 4 — INVENTORIES

The inventories of the consolidated companies have been priced on the basis of cost or market whichever lower, after eliminating estimated intercompany profits included therein. In general, cost as applied to inventory valuation represents current actual cost or current average purchase or manufacturing cost computed under the "first in, first out" method.

NOTE 5 — MISCELLANEOUS INVESTMENTS

Miscellaneous investments of $851,703 at December 31, 1944 include $690,000 representing the estimated net amount to be realized from the liquidation of United Drug Company's investment in Sontag Chain Stores Co., Ltd. and the termination of an escrow agreement relating thereto. In the latter part of 1944 United Drug Company deposited $2,112,806 in escrow, an amount sufficient to acquire all of the capital stock of Sontag Chain Stores Co., Ltd. under an offer of purchase made to the stockholders of the latter company. At December 31, 1944 approximately 79% of the stock of this company had been acquired and a balance of $448,626 remained on deposit under the escrow agreement for the purchase of additional shares which might be offered for sale subsequent to that date. An additional 8% of the stock has been acquired up to February 19, 1945.

As of November 30, 1944 Sontag Chain Stores Co., Ltd. conveyed its business, assets, leases, etc., subject to liabilities, to United Drug Company for a consideration of $1,972,198 (*the book value of assets acquired, less liabilities*), of which $1,301,034, after certain adjustments, remained unpaid as at December 31, 1944.

It is anticipated that Sontag Chain Stores Co., Ltd. will be liquidated in 1945. United Drug Company's unpaid obligation to that company of $1,301,034 has been offset in the December 31, 1944 consolidated balance sheet against the sum of the cost of its investment in shares of Sontag Chain Stores Co., Ltd. and amounts remaining on deposit under the escrow agreement. The transaction has been treated in this manner on the basis that the intercompany obligation will be offset in the liquidation of Sontag Chain Stores Co., Ltd. and that United Drug Company will receive, in addition to the offset of the obligation, an estimated amount of $690,000 from the liquidation and from the termination of the escrow agreement.

The excess, amounting to $113,211, of the net cost of the investment to United Drug Company as at December 31, 1944, over the book value of assets acquired, less liabilities, has been charged to profit and loss in 1944 as "leaseholds, etc. purchased", pursuant to the companies' established policy relating to similar intangibles.

Miscellaneous investments at December 31, 1944 also include, as in prior years, an investment of doubtful value in an affiliated company, which is carried at a nominal amount of $1.

NOTE 6 — GOODWILL, TRADE-MARKS, ETC.

In addition to reductions made in previous years, the balance sheet amount of consolidated goodwill, trade-marks, etc., $3,000,000 as at December 31, 1943, was reduced to a nominal amount of $1 in 1944 by a charge to earned surplus, without any implication that the item is not worth as much as, or more than, amounts at which it has formerly been carried.

NOTE 7 — RESERVES FOR ESTIMATED FEDERAL AND CANADIAN INCOME AND EXCESS PROFITS TAXES AND FOR RENEGOTIATION

The reserves for federal and Canadian taxes on income at December 31, 1944 are considered to be reasonable and adequate to cover all such accrued and unpaid taxes, but the companies' liabilities therefor are subject to final determination by the respective taxing authorities. The Bureau of Internal

Revenue has not yet examined the consolidated federal income and excess profits tax returns for the years 1942 and 1943 of United Drug, Inc. and its domestic subsidiaries affiliated for tax purposes.

The 1944 and 1943 provisions for the federal excess profits tax, charged to profit and loss, are after deducting, for 1944, an estimated debt retirement credit of $200,000 and postwar credit of $613,000, and, for 1943, an estimated debt retirement credit of $620,000. The 1944 provision for Canadian income and excess profits taxes is after deducting the estimated postwar credit of $25,000. The 1943 Canadian postwar credit of $29,694, not credited to profit and loss in that year, has been credited to earned surplus in 1944.

Certain of the subsidiaries are subject to renegotiation of earnings on 1944 war business under the provisions of the "War Profits Control Act". Reasonable provision therefor has been made in the accounts on the basis of the companies' previous experience in such proceedings. Renegotiation proceedings with respect to prior years' earnings have been concluded with the result that such earnings have been determined by the Government not to be excessive.

NOTE 8 — PREFERRED STOCK

The holders of preferred stock of United Drug Company are entitled to receive $104 per share upon redemption or voluntary liquidation on or before August 1, 1951 ($102.50 *per share thereafter*) or $100 per share upon involuntary liquidation, plus, in either case, accrued unpaid dividends. Reference is made to the comments contained in Note 9 relative to the preferred stock Purchase Fund.

NOTE 9 — EARNED SURPLUS

The consolidated earned surplus of United Drug, Inc. and its subsidiaries covers the period since September 1, 1933, the approximate date of organization of United Drug, Inc. The balance thereof at December 31, 1944, $11,317,678, was represented by $126,084 of earned surplus of United Drug, Inc. and $11,191,594 of undistributed consolidated surplus earnings of United Drug Company and subsidiaries since September 1, 1933. The latter amount includes $250,000 which, pursuant to the company's amended Certificate of Incorporation, was appropriated and set apart on the books of United Drug Company as of May 1, 1944 as a Purchase Fund for the purchase of its preferred stock at not in excess of $100 per share. The Certificate of Incorporation also provides that $250,000 or less, under certain conditions, shall be similarly set apart for the same purpose on May 1, 1945 and each subsequent May 1 thereafter so long as any shares of preferred stock remain outstanding, and provides for the cancellation after one year of the unused portion of each of such Purchase Funds.

Under the terms of the indenture covering outstanding Fifteen Year 3¼% Sinking Fund Debentures of United Drug Company, approximately $3,367,000 only of the $11,191,594, referred to above, of undistributed consolidated surplus earnings of United Drug Company and subsidiaries since September 1, 1933 was available for distribution to the parent company, United Drug, Inc., in the form of dividends on common stock of United Drug Company.

NOTE 10 — EXECUTIVE STOCK OPTIONS

At December 31, 1944 certain executives held options, granted in 1944, to purchase from United Drug Company, over a period of years, at a price of $12.75 per share, 46,500 of the 48,478 shares of capital stock of United Drug, Inc. held by United Drug Company. The amount of 46,500 shares is after deducting 500 shares the option for which was exercised during 1944. The excess, over average cost, of the proceeds from the sale of the 500 shares has been credited to capital surplus.

Printed in U.S.A.